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Economic Outlook

Irving Trust

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The long-awaited recovery is still being awaited. Although it is now possible to point to a few favorable economic statistics, the general tenor of the economy remains weak. Despite continued declines in the industrial sector, real GNP will probably register a small increase in the current quarter after showing little change in the third quarter. General business conditions are expected to show more decisive improvement during the first quarter of next year, with real GNP increasing at a moderate pace throughout 1983.

Industrial production and payroll employment continue to fall, with little evidence of abatement. The housing market, however, is beginning to show some signs of life, an encouraging development since any general recovery will likely be led by improvement in consumer spending and home sales. The faint increases in retail sales have been concentrated in auto sales, which have been supported by various incentives programs. The lackluster performance of nonauto retail sales can be partially traced to a smaller-than-expected rise in real disposable personal income.

Real disposable personal income increased at only a 2.3% annual rate in the third quarter following a 3.7% increase in the second quarter. Such a modest increase was surprising in view of July's tax cut and increase in Social Security benefits. Part of the problem was that rapid escalation of gas and electricity prices--12.5% at an annual rate--masked the general moderation in inflation in the consumer sector. More fundamental, however, was the sharp drop in payroll employment during the third quarter. The associated drops in income, as well as the sharply reduced level of employment since the beginning of the recession, have substantially offset and diluted the aggregative thrust of the tax cuts.

It is clear, then, that the employment situation must stabilize for the recovery to begin. The signs here are mixed. Initial claims for unemployment insurance have begun to fall but remain at a high level. Moreover, it appears that inventories in general are still undesirably high relative to sales, suggesting that production (and hence employment) will continue to be restrained for a few more months, although there is some indication that the inventory situation is coming under control. For example, manufacturers' inventories have fallen steadily since April, with September showing a substantial 0.8% decline.

The declines in interest rates since last July have been crucial for economic recovery, but even here the outlook is cloudy. Despite these declines, real interest rates remain high enough to delay the recovery. Our view is that the economy is still so weak that there is sufficient slack to minimize the risks of reigniting inflation if further moderate easing actions are undertaken. As a result, we think a further modest decline in rates is warranted and likely. Nevertheless, some analysts still find the recent explosive growth in the various monetary aggregates--despite expected churning in deposits as "all-savers" certificates mature--sufficient reason to forestall further rate declines. It will be interesting to see how the Federal Reserve grapples with this dilemma.

Bernard Schoenfeld

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Economic Forecast

Percent Changes at Annual Rates

	Actual				Forecast				Actual	Forecast	
	1982			1982	1983				1980-	1981-	1982-
	I	II	III	IV	I	II	III	IV	1981	1982	1983
Gross National Product	-1.0	6.8	6.2	7.2	8.9	9.9	9.2	9.6	11.6	4.5	8.4
Real GNP	-5.1	2.1	0.8	2.0	3.7	4.5	3.8	4.0	1.9	-1.5	3.1
GNP Price Deflator	4.3	4.6	5.4	5.1	5.0	5.2	5.2	5.4	9.4	6.1	5.1

	Actual	Forecast	Actual	Forecast	
	1982:III	1982: IV	1980-1981	1981-1982	1982-1983
Consumer Spending	8.8%	9.4%	10.6%	7.0%	8.7%
Durable Goods	-0.2	5.3	9.4	2.6	8.2
Nondurable Goods	8.6	8.0	9.6	4.2	8.3
Services	11.4	11.5	11.7	10.6	9.2
Business Capital Spending	-11.5	1.5	12.0	0.7	4.4
Structures	-8.3	4.6	17.4	9.4	4.2
Equipment	-13.7	-0.4	8.9	-4.6	4.5
Residential Investment	7.9	15.0	1.7	-7.7	22.0
			1981	1982	1983
Change in Inventories	$-0.5b.	$-2.0b.	$20.5b.	$-13.6b.	$13.0b.
Net Exports of Goods and Services	$13.2b.	$12.0b.	$26.1b.	$22.9b.	$13.2b.
			1980-1981	1981-1982	1982-1983
Government Purchases	12.8%	4.4%	10.9%	7.6%	5.0%
Federal	23.5	2.0	16.1	10.4	4.5
Defense	18.1	4.4	17.0	15.8	5.6
Other	38.2	-4.3	14.3	-0.8	1.9
State & Local	6.4	6.2	7.9	5.8	5.3
Corporate Profits Before Tax	-16.8*F	-5.5*	-4.2	-20.1	19.0
Corporate Profits After Tax	-12.1*F	-3.5*	-4.4	-16.6	19.0
Plant and Equipment Expenditures	-7.0F	4.0	8.7	0.2	4.0
Real Final Sales#	-0.6	2.9	1.0	-0.6	2.3
Real Disposable Personal Income	2.3	0.7	2.5	1.3	2.3

Economic Indicators	Recent Data			Actual	Forecast	
	July	Aug.	Sept.	1980-1981	1981-1982	1982-1983
Consumer Price Index**	7.2%	3.6%	2.4%	8.9%	5.4%	5.0%
Producer Price Index for Finished Goods**	7.2	7.2	-1.2	7.0	3.7	5.0
Industrial Production	1.2	-3.6	-8.4	2.9	-8.1	2.4
Retail Sales##	1.6	-1.1	0.6	9.4	2.7	8.3
				1981	1982	1983
Auto Sales (millions of units, a.r.)	7.4	7.6	8.3	8.5	7.9	9.0
Housing Starts (millions of units, a.r.)	1.19	1.00	1.15	1.08	1.04	1.32
Unemployment Rate	9.8	9.8	10.1	7.6	9.7	9.7
Merchandise Trade Deficit (a.r.)	$29.1b.	$85.0b.	$50.3b.	$39.7b.	$44.0b.	$70.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

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#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).
$b. = billions a.r. = annual rate F = Forecast